Issues and Recommendations Concerning
Servicing of Mortgage Debt and the
Fair Debt Collection Practices Act

Submitted by the Mortgage Bankers Association
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Under the current Fair Debt Collection Practices Act ("FDCPA" or "the Act"), when a mortgage servicer acquires a loan portfolio; it is generally exempt from complying with the FDCPA because the Act extends the creditor's exemption to the new lender/servicer. However, servicers are deemed "debt collectors" under the Act if they acquire servicing rights on a loan in "default." The Federal Trade Commission's ("FTC's") *DeMayo* opinion concluded that the word "default" was to be defined by looking to (in order): (a) the underlying contract; (b) applicable state or federal law; or (c) a creditor's reasonable written guidelines. Unfortunately, the standard Fannie Mae/Freddie Mac note defines a loan as being in default if not paid on the due date (i.e., first of the month).

As a result, many loans are considered "in default" and subject to the debt validation notice ("DVN"), Miranda notices, and other provisions, despite the fact that the financial services industry offers a 15-day grace period and does not consider a loan to be in default until at least 30 or more days past due. Moreover, unlike other debt collectors, servicers of acquired servicing rights purchase a long-term relationship with the debtor. A key purpose of the servicing acquisition is to maintain a long-term relationship with the borrower in order to collect the servicing fee, obtain repeat business, and cross sell products that can only be accomplished if the loan performs. True debt collectors' relationships with debtors terminate upon collection of the delinquent debts or installments. No further communication is exchanged with true debt collectors.

It is important to point out that servicing rights are actively traded today, unlike the case when the FDCPA was enacted. Servicing trades are done for various business purposes, including the need to manage capital, business capacity/ economies of scale, delivery methods (correspondent lending), income, and to obtain a long-term asset and relationship. The purpose of the servicing transfer is not to recoup ***only*** delinquent installments. In fact, the vast majority of servicing transfers involve loans that the industry does not treat as delinquent.

Mortgage Bankers Association's Recommendation: Servicers of mortgage loans should not be considered debt collectors under the FDCPA, even if a loan transferred is contractually in default.

Below are various reasons why the FDCPA is not appropriate when applied to mortgage servicers:

A. **Miranda Warning: Scares Customers, Detrimental to Customer Relationship**

Among the provisions of the FDCPA is a requirement that a debt collector provide a debtor with a "Miranda" warning upon initial contact with a debtor, and a shorter "mini-Miranda" in all subsequent contacts (written and oral) for the life of the loan. The Miranda notices require the collector to identify itself as a "debt collector," and to disclose that the contact represents an attempt to collect a debt and that any information will be used for that purpose. The purpose of these warnings is to prevent collectors from using false or deceptive tactics (such as a phony sweepstakes winning) to trick consumers into divulging private financial information, home address and telephone numbers.

However, in the context of a mortgage servicing transfer, the Miranda notice requirements are both unnecessary and detrimental to consumers. In short, the notice:

- **Misleads the borrower about the nature of the new servicer's relationship.** Unlike true third party debt collectors, mortgage servicers have long-term relationships with borrowers. The harshly worded Miranda notice actually discourages delinquent borrowers from contacting their new servicer out of fear that the company is simply another debt collector. This ends up frustrating servicer efforts to work with delinquent borrowers on work-out options that can bring their loans current. A mortgage servicer's biggest problem in working with seriously delinquent borrowers is simply getting them to call back (50 percent of all borrowers who reach foreclosure have not talked to the servicer, despite multiple attempts by the servicer). The Miranda notice only contributes to that fear and does nothing to protect the homeowner.

- **"Protects" borrowers from providing information that the mortgage servicer *already has in its possession*.** Unlike true debt collectors, mortgage servicers already have detailed information about the borrower in the loan files that accompany a loan sale or servicing transfer, including address, bank account information, credit report information, social security number, etc.

- **Hurts customer relationships both at the initiation of the relationship, and for the remaining term of the mortgage.** The initial Miranda warning is typically sent with the new servicer's "Hello" or welcome letter that is required under RESPA and provides important information about the new servicer and the borrower's monthly payment arrangement. It is also the servicer's first opportunity to establish a healthy customer relationship. The juxtaposition of the stark Miranda warning with the welcome letter creates customer relations problems for servicers from the outset of the relationship. Moreover, the mini-Miranda is required in all subsequent contacts with the borrower, even after customers have brought their loans current and maintained them that way for years.

B. **Debt Validation Notices Confuse Borrowers and Provide Misleading Information.**

Under current FDCPA, debt collectors are required to send within five days of initial communication with borrowers, debt validation notices that contain, among other pieces of information, the amount of the debt and statements concerning verification and validity of the debt. Several concerns arise as a result of the DVN requirement:

- **Acceleration Implied:** If the borrower is delinquent by one or two installments at the time of the servicing transfer, sending the DVN and indicating that the amount due is the full principal balance owed on the loan, implies that the loan has been accelerated, when in most instances it has not.

- **Unclear Phrase:** It is unclear what an initial “communication with the consumer in connection with the collection of any debt” means in the context of on-going mortgage servicing, where servicers are required to send “Hello”/welcome letters upon servicing transfer; commonly send monthly statements to collect monthly installments, and provide other related communications, including escrow notices.

- **Overdisclosure:** Servicing systems do not provide a means to distinguish which loans were current or in default when the servicing was transferred. As a result, all loans are considered covered by the FDCPA regardless of payment status and, thus, receive DVNs (and Mirandas). The notice is confusing to borrowers, especially borrowers who are current or within the grace period.

- **Timing:** Servicers also have difficulty providing the “amount of the debt” required under section 809(1) in the context of servicing transfers because, in many cases, the initial communication is the “Hello” letter

that is sent prior to the loan being boarded on the new servicer's system. The servicer, therefore, can't properly complete the DVN.

C. Miscellaneous Problems with FDCPA

In addition to the significant concerns listed above, servicers continue to struggle to comply with FDCPA's other provisions. We highlight additional problems servicers face:

1. Conflicts with Other Laws.

State and Federal Notices: There is considerable confusion over whether Section 805(c) bars state and federally required notices (such as the homeownership counseling notice, right to cure, UCC Notice of Sale, etc), pro-consumer solicitations for loss mitigation, and important notices such as insurance and tax notices.

Federal Bankruptcy Code: The FDCPA and the Federal Bankruptcy Code are at odds. The FDCPA requires the servicer to send a DVN to a borrower under certain situations. The DVN notice, however, often contains the "Miranda" notice indicating that the letter is an attempt to collect a debt. Servicers are at risk of violating the automatic stay under the Bankruptcy Code for making this statement. There is no exemption/exclusion under either law for this situation. To avoid liability, servicers have included explanatory language indicating that the Miranda language is federally required and that the DVN is being given for informational purposes only.

2. Ceasing Communications with the Borrower:

Borrower's Attorney: The Act requires debt collectors to communicate only with an attorney once the servicer knows (or should know) that a borrower is represented by counsel in connection with the loan. Problems have arisen when an attorney is representing the borrower in a divorce action and is handling the property division (which will include the home and the debt that goes along with it). In most of these situations, the attorney is unwilling to deal with the servicer in terms of loss mitigation and other collection-related matters.

3. Technology:

Voice Messages: There are three recent cases which hold that a debt collector cannot leave a message, including a pre-recorded message, on an answering machine without disclosing that it is a debt collector. *Belin v. Litton Loan Servicing*, 2006 WL 1992410 (MD FL. July 14, 2006); *Foti v.*

NCO, 424 F.Supp.2d 643 (SD NY 2006); *Hosseinzadeh v. MRS Associates, Inc*., 387 F.Supp.2d 1104 (CD CA 2005). This is a shift from prior cases that hold that debt collectors cannot disclose the nature of the call on an answering machine because the debt collector (i.e., servicer) has no way to verify that only the customer will be listening to the message (it is a violation to disclose to a third party that the debt collector is calling about a debt). Conflicting opinions on pre-recorded messages create unnecessary liability for lenders.

Cell Phones, Emails: New technology has arisen since enactment of the Act, including cell phones and emails. It is unclear how these new methods of communicating interface with the FDCPA requirements. For example, given that cell phones are not locked to a location, it is difficult for servicers to comply with the calling time frames permitted under the Act, which are based on the "consumer's location" versus the location of the real estate. Cell phones in some cases are replacing land lines and may be the primary vehicle for contacting borrowers to discuss arrearages, loss mitigation or other issues surrounding their debts.

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The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.